BEAUTILAND CO. LTD.

v.

THE COMMISSIONER OF INLAND REVENUE

PRIVY COUNCIL
LORD KEITH OF KINKEL
LORD TEMPLEMAN
LORD OLIVER OF AYLMERTON
LORD JAUNCEY OF TULLICHETTLE
ROBERT MEGARRY
[PRIVY COUNCIL APPEAL NO. 51 OF 1990]
19 JUNE 1991

REVENUE LAW: *Profits tax - Whether shares acquired and disposed of by way of trade or adventure in the nature of trade - Joint venture agreement for development of land - Whether trading in shares of subsidiary or associated companies - Definition of properties - Recital and schedule - Whether included shares - Inland Revenue Ordinance, [HK] ss. 2(1), 14.*

In June 1979, company C and company CLC, a subsidiary of W, entered into a joint venture agreement in relation to the development of certain landed properties owned by subsidiaries of W together with certain other properties owned wholly or partially by subsidiaries of C (the said development). A company named B, the appellant, was incorporated for the purpose of carrying out the said development. C offered 30% of the issued share capital of R, which owned 52.36% shares of L, which owned valuable land at TSW in the New Territories (the said land). It was agreed that C and CLC would hold 50% of the shares in B.

B resolved to purchase the areas of land and shares set out in the Schedules to the joint venture agreement, including the 30% shareholding in R. In August 1979, C offered to sell to X 81% of the shares in R, including 25% out of the 30% acquired by B, for a total price of $336,150,000 of which B's share was $103,750,000. On 6 November 1979, B and the shareholders in R sold X 25% of its 30% holding at the agreed price of $103,750,000. B thus made a gain of approximately $40,000,000.

The respondent, the Commissioner of Inland Revenue assessed B to profits tax for the year 1980/81. B's appeal to the Board of Review was dismissed. B then requested that the case be stated for the opinion of the High Court on the issue of whether as a matter of law, and on the facts found by the Board, it was open to the Board of Review to hold that the R shares were acquired and disposed of by way of trade or adventure in the nature of trade.

The High Court allowed B's appeal but the Court of Appeal reversed this decision. This is B's appeal to the Privy Council.

Held:

[1] The words "properties described in the schedules" in the joint venture agreement, in their natural and ordinary meaning, refer to the landed properties so described and are not apt to embrace shares in companies. Although in the definition clause, the Properties (with a capital P) is defined as including "assets and shares" being those "referred to" (not "described") in the Schedules, the context of the reference to "the properties" (with a small "p") in the recital to the agreement makes it clear that the definition of "the Properties" is not imported.

[2] A proper construction of the operative parts of the joint venture agreement indicates that what was in the contemplation of the parties, and their intended purpose, was the turning to account of land by development or sale or both, whether such land was to be owned directly by B or would be owned by subsidiary or associated companies of B.

[3] The joint venture agreement did not indicate that the parties had in contemplation trading in the shares of a subsidiary or associated companies. If there was no such contemplation, there can be no question of a separate contemplation of trading in land *via* shares, a concept which their Lordships found difficult to understand.

[4] The offers made to C for the purchase of R's interest in certain land, and the prospect of further and better offers, are not grounds for inferring an intention on the part of the parties that the shares of R should be acquired by B not as part of its capital structure but as trading stock. On the facts and circumstances, the acquisition and disposal by B of the R shares was not an adventure in the nature of trade.

[Appeal allowed.]

Legislation referred to:
Inland Revenue Ordinance [HK], ss. 2(1), 14

JUDGMENT

Lord Keith of Kinkel:

The proceedings with which this appeal is concerned arose out of a joint venture agreement entered into on 8 June 1979 between two important Hong Kong companies, Cheung Kong (Holdings) Ltd. (Cheung Kong) and Wheelock Marden & Co. Ltd. (Wheelock Marden), acting through its subsidiary company Cranmore Land Co. Ltd. (Cranmore). The first approach for this venture was made by Cheung Kong on 12 March 1979. In the course of an exchange of letters during that month agreement in principle was reached for the joint development of certain landed properties owned by subsidiaries of Wheelock Marden together with certain other such properties owned wholly or partially by subsidiaries of Cheung Kong. The development was to be carried out through the vehicle of a company called Beautiland Company Limited, which was incorporated on 27 March 1979 and is the appellant in this appeal. Among the assets offered by Cheung Kong was 30% of the issued share capital of a company called Rostock Enterprises Ltd. (Rostock) which owned 52.36% of the shares of Luen Tak Company, which itself owned valuable land at Tin Shui Wai in the New Territories.

On 19 April 1979 Cheung Kong sent to Wheelock Marden a draft of the proposed agreement for the joint venture. In May 1979 an outside party approached Cheung Kong offering to purchase Rostock's interest in the land at Tin Shui Wai. This offer was not accepted. The draft joint venture agreement was subjected to various alterations, and in its final form was executed by Cranmore and Cheung Kong on 8 June 1979. It was provided that each of Cranmore and Cheung Kong should hold 50% of the shares in Beautiland. Clause 1 of the agreement defined "the Properties" as meaning:

> All the assets and shares and proportions thereof referred to in Schedules I and II of this agreement and which are to be acquired from the sellers by (Beautiland).

It further defined "the Seller" as:

> Any party which is to sell to (Beautiland) the property owned by it or the shares in any of its related companies as set out in the relevant schedules hereto.

Clause 7.1 provided:

> (Beautiland) or its subsidiaries shall purchase from the Sellers, and Cranmore and Cheung Kong shall sell or otherwise cause the Sellers to sell to (Beautiland) or its subsidiaries the properties at the prices and upon the terms of payment and conditions as are respectively set out in Schedule I and Schedule II hereto and subject to the provisions of this agreement.

Schedule I set out the Properties (in the sense of assets and shares) to be put into the venture by Wheelock Marden. These comprised ten areas of land each owned by a separate subsidiary and a 100% holding of shares in another subsidiary. Schedule II set out the Properties to be put in by Cheung Kong. These consisted entirely of shareholdings in nine different subsidiaries, ranging from a 10% to a 100% holding, and including the 30% shareholding in Rostock. The schedules also set out the price to be paid by Beautiland for each area of land and each shareholding to be acquired by it, the price to be paid for the Rostock holding being $60,124,688.17, and provided for the prices to be paid as to 5% upon signing of the agreement, 5% within 12 months of signing and 90% within 48 months of signing.

Clause 10 of the agreement (in which, as elsewhere, Beautiland is called "the company"), is headed "Development Policy". It provided:

> 10.1. All the land owned by the company and/or by the subsidiary companies of the company shall be developed by erecting thereon new buildings at such time and in such manner as the managing director shall decide: Provided that the building plans, specifications and the budgetted costs for each new building shall be subject to the approval of the board of directors.
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> 10.2. Notwithstanding Clause 10.1. hereof, the existing buildings on any land owned by the company or the subsidiary companies of the company may be turned to account otherwise than by the development thereof if the board of directors shall so resolve.
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> 10.3. The rights of exchange for land under letters of exchange and the right (legal or equitable) to any land held by the subsidiary companies of the company shall be utilized or otherwise turned to account at such time and in such manner as the managing director shall, subject to the approval from time to time of the board of directors, decide.
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> 10.4. Any land to be developed by the company or the subsidiary companies of the company shall be developed as expeditiously as possible and to the best and fullest extent as shall for the time being be permitted by the relevant government authorities.
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> 10.5. Each of the parties hereto shall use its best endeavours to procure the board of directors of such of its related companies, of which issued share capitals less than 50% have been sold to the company, to have the land and the existing buildings thereon owned by such related companies, or the right to exchange for land held by such related companies, to be developed or otherwise turned to account as the board of directors shall decide.

On the same day as the joint venture agreement was executed, namely 8 June 1979, Cranmore sent to Cheung Kong a letter containing the following passage:

> We refer to the joint venture agreement of even date and made between ourselves, Cranmore Land Company Limited, of the one part and yourselves, Cheung Kong (Holdings) Limited, of the other part for the formation of a consortium in Beautiland Company Limited (Beautiland) of which your Mr. Li Ka Shing is to be the managing director as provided in the said joint venture agreement.
>
> We hereby confirm our agreement that your Mr. Li Ka Shing shall have the full authority and power for and on behalf of Beautiland:

(1) To negotiate and agree with prospective purchaser or purchasers, at such prices and on such terms and conditions as would in his absolute opinion generate a reasonable profit, for the sale or disposal of either the interest held by Rostock Enterprises Limited of and in the pieces of land registered in the District Office Yuen Long respectively as subsection land the remaining portion of s. B of Lot No. 165 in Demarcation District No. 126 or the shares in Rostock Enterprises Limited to be acquired by Beautiland.

By board resolution dated 27 June 1979 Beautiland resolved to purchase the areas of land and the shares set out in the schedules to the joint venture agreement, including the 30% shareholding in Rostock. On 28 June 1979 contract notes for the purchase and sale of that shareholding were executed. In August 1979 approaches were made to Cheung Kong by Commotra Company Limited (Commotra) with a view to acquiring an interest in the land at Tin Shui Wai. Commotra was a different party from the one who had made the offer in May 1979. The result of the approaches was that on 21 August 1979 Cheung Kong offered to sell to Commotra 81% of the shares in Rostock, including 25% out of the 30% acquired by Beautiland, at a total price of $336,150,000 of which Beautiland's share was $103,750,000. On 6 November 1979 Beautiland joined with other shareholders in Rostock in an agreement for the sale to Commotra of *inter alia* 25% out of its 30% holding at the agreed price of $103,750,000. Beautiland thus made a gain of some $40,000,000. The exact amount does not appear anywhere in the record.

The Commissioner of Inland Revenue, the respondent in this appeal, made an assessment to profits tax upon Beautiland for the year 1980/81 charging *inter alia* the gain so made by it. Beautiland appealed to the Board of Review against the assessment so far as relating to the gain on the Rostock shareholding, and also to a gain made on the disposal to Cheung Kong on 20 October 1979 of shares in a company called Hoi Tuen Investment Co. Ltd. By decision dated 3 June 1989 the Board of Review dismissed the appeal insofar as relating to the assessment in respect of the Rostock share transaction, holding that it was either carried out by way of trade or was an adventure in the nature of trade, but allowed the appeal as regards the Hoi Tuen share transaction, holding that these shares were acquired by Beautiland as a long term investment and were never part of its stock in trade. At Beautiland's request the Board of Review stated a case for the opinion of the High Court. The case contained a number of questions of law, but it will be sufficient to mention only the first of these, which is in these terms:

> Whether, as a matter of law, and on the facts found by the board, it was open to the Board of Review to hold that the Rostock shares were acquired and disposed of by way of trade or adventure in the nature of trade.

On 9 November 1989 Barnett J delivered judgment whereby he answered this question in the negative and allowed Beautiland's appeal. On appeal by the Commissioner, the Court of Appeal (Power JA, MacDougall JA and Hooper J) on 4 September 1990 reversed the decision of Barnett J. Beautiland now appeals to Her Majesty in Council.

Section 14 of the Hong Kong Inland Revenue Ordinance imposes for each year of assessment a charge for profits tax on every person carrying on "a trade, profession or business in Hong Kong" in respect of his assessable profits arising in or derived from Hong Kong "from such trade, profession or business". Section 2(1) of the Ordinance defines "trade" as including "every trade and manufacture, and every adventure and concern in the nature of trade". This does not differ materially from the United Kingdom definition "every trade, manufacture, adventure, or concern in the nature of trade", which has given rise to a great many cases each turning largely on its own facts and circumstances. In the present case the first matter for consideration is whether or not the joint venture agreement contains any indication of

an intention to carry on a general trade in the shares of the land owning companies which were to be acquired by Beautiland. In this connection the Board of Review said in the course of its decision:

> We find nothing in the bargain which excluded from the parties' contemplation the sale of shares owned by the joint venture company. We find that the parties' general intent to enter into a long-term venture for developing and/or turning landed properties to profitable account made allowance for profit-taking sales before development, the phrase 'development and/or sale of the properties described in the schedules' being perfectly consistent with this general intention. We also find such profit-taking sales were intended to form part of the venture and that the intention was sufficiently broad to encompass trading in shares or trading in land *via* shares in relation to specific assets owned.

The phrase to which the Board of Review here refers comes from the first recital to the agreement, which is in these terms:

> The parties hereto are desirous of participating in the development and/or sale of the properties described in the schedules hereto.

The schedules are headed by the names of various companies, and against the words "location of property" and "description" they describe under each name the landed properties owned by the company in question. In some instances Beautiland was to acquire shares in the company, and in others the landed properties owned by the company. The words "properties described in the schedules" in their natural meaning refer to the landed properties so described and are not apt to embrace shares in companies. Shares are not normally referred to as properties and although shares are mentioned in the schedules, against the words "percentage of shares to be acquired", they can hardly be regarded as described there. It is true that in the definition clause "the Properties" (with a large "P") is defined as including "assets and shares", being those "referred to" (not "described") in the schedules. But the context of the reference to "the properties" (with a small "p") in the recital makes it clear that the definition of "the Properties" is not imported. When attention is turned to the operative parts of the agreement, a proper construction of these bears out that what was in the contemplation of the parties, and their intended purpose, was the turning to account of land by development or sale or both, whether such land was to be owned directly by Beautiland or would be owned by subsidiary or associated companies of Beautiland. This is particularly apparent from Clause 10, dealing with development policy, which has been quoted above. Beautiland was to own certain landed properties as its stock in trade and the subsidiary and associated companies were to own other landed properties as their stock in trade.

Their Lordships are unable to find anything in the agreement which indicates that the parties had in contemplation trading in the shares of subsidiary or associated companies. In so far as the Board of Review found such a contemplation to exist, their Lordships consider that the board misinterpreted the agreement. If there was no contemplation of trading in the shares of subsidiary or associated companies there can be no question of a separate contemplation of trading in land *via* shares, a concept which their Lordships in any event find difficult to understand. The Board of Review placed some weight upon the terms of Clause 7.1 of the first draft agreement, which contained a provision for accelerated payment to either of the parties of the price of any land or shares in a related company acquired by Beautiland from that party in the event *inter alia* of Beautiland having by sale disposed of such land or shares before the due dates for payment of instalments of the purchase price set out in the schedules. This provision was, however, omitted from the agreement as finally executed, which tends to suggest, if anything, that the sale of the shares in the related companies which were to be acquired by Beautiland was not at the end of the day in the general contemplation of the parties.

The actual activities of Beautiland after acquiring the agreed assets do not present any characteristics of a general trade in shares. The land to be acquired from Wheelock Marden, apart from two parcels, TWIL No. 2 and TWIL No. 16, was acquired through wholly owned subsidiaries of Beautiland. Beautiland sold TWIL No. 2 and TWIL No. 16 in December 1980 and accepted an assessment to profits tax on the resulting gain. On 25 October 1979 Beautiland sold back to Cheung Kong the 100% shareholding in Hoi Tuen Investment Co. Ltd. which it had acquired from Cheung Kong under the joint venture agreement. This resulted in a gain to Beautiland of $80,000,000, and the Commissioner assessed Beautiland to profits tax in respect of this gain. As already mentioned the Board of Review heard an appeal by Beautiland against this assessment along with the Rostock appeal and allowed it, holding that the Hoi Tuen shares were acquired by Beautiland as a long-term investment and never formed part of its stock in trade. The Board of Review decision annexed to the case stated sets out in paras. 26 and 27 certain acquisitions and disposals by Beautiland of shares in certain companies between September 1979 and February 1986, but the Board of Review nowhere suggests that any of these were trading transactions. The acquisition and disposal of the Rostock shares, if it was a trading transaction, was unique.

The conclusion is that there was no material before the Board of Review upon which it could properly find that the Rostock shares were acquired and disposed of by Beautiland by way and in the course of a general trade in shares. It remains to consider whether it could properly be regarded as a one-off adventure in the nature of trade. The broad purpose of the joint venture agreement was to bring about the profitable development of land. Beautiland was to become owner of a number of parcels of land as stock in trade, and it was also to become the holding company for a number of subsidiary or related companies which themselves would own land as stock in trade. In the result Beautiland came to own only two parcels of land, TWIL No. 2 and TWIL No. 16, and all the other parcels were owned by subsidiary or related companies. In general, the shares in these companies held by Beautiland constituted its capital structure, and the question is whether the Rostock shares were exceptional in respect that they were acquired not as part of that capital structure but as trading stock. The Board of Review held that the latter was the position. Its principal reason for so holding was that when Beautiland acquired the Rostock shares on 28 June 1979 it did not have any intention to hold the shares for long term investment, because the shares were marketable items and there would be legal and other problems in the way of either developing the land at Tin Shui Wai or selling Rostock's shares in Luen Tak, which owned that land. The board was much influenced by the circumstances that in May 1979 there had been an approach to Cheung Kong with a view to the purchase for $300,000,000 of Rostock's interest in Tin Shui Wai, and that on 8 June 1979 Mr. Li Ka Shing had been authorised to negotiate for the sale either of that interest or of the Rostock shares to be acquired by Beautiland.

In their Lordships' opinion these circumstances are quite insufficient to support the Board of Review's conclusion. The Rostock shares were originally put forward by Cheung Kong for the joint venture upon exactly the same basis as the shares in the other eight companies which they were offering. Cheung Kong refused an offer for Rostock's interest in the land at Tin Shui Wai in May 1979. The offer by Commotra in August 1979 was a better one. In June 1979 there was undoubtedly the prospect of further and better offers, but that prospect gives no grounds whatever for inferring an intention on the part of the parties to the joint venture that the Rostock shares should be acquired by Beautiland not as part of its capital structure but as trading stock. The true view is that the appearance of a fortuitous offer at a very good price caused Beautiland to decide to sell part of its capital structure. No doubt the difficulties which would confront the development of the land at Tin Shui Wai contributed

to that decision, but the presence of those difficulties is no ground for inferring that the Rostock shares were not originally acquired as part of the capital structure of Beautiland. The contrary conclusion to that reached by the Board of Review is the only true and reasonable one upon a consideration of the whole facts and circumstances of the case. The acquisition and disposal by Beautiland of the Rostock shares was not an adventure in the nature of trade.

For these reasons their Lordships will humbly advise Her Majesty that the appeal should be allowed and the order of Barnett J restored. The respondent must pay the appellant's costs here and before the Court of Appeal.

Also found at [1991] 3 CLJ 1675